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C O N F I D E N T I A L SECTION 01 OF 07 ASHGABAT 001168

SIPDIS

STATE FOR SCA/CEN; EEB;  
EUR FOR C. BOYDEN GRAY  
PLEASE PASS TO USTDA DAN STEIN  
ENERGY FOR EKIMOFF/THOMPSON  
COMMERCE FOR HUEPER

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SUBJECT: TURKMENISTAN: FOREIGN ENERGY COMPANIES PRESS ON  
IN FACE OF CHALLENGES

REF: A. ASHGABAT 0964  
[1](#)B. ASHGABAT 0884  
[1](#)C. ASHGABAT 1139  
[1](#)D. ASHGABAT 0829  
[1](#)E. ASHGABAT 0686  
[1](#)F. ASHGABAT 1142  
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[1](#)H. ASHGABAT 0903  
[1](#)I. ASHGABAT 0894  
[1](#)J. ASHGABAT 0763  
[1](#)K. ASHGABAT 0762  
[1](#)L. ASHGABAT 1137  
[1](#)M. ASHGABAT 0741  
[1](#)N. ASHGABAT 0740  
[1](#)O. ASHGABAT 0771  
[1](#)P. ASHGABAT 0605  
[1](#)Q. ASHGABAT 1045

Classified By: Charge Sylvia Reed Curran for reasons 1.4 (b) and (d).

[1](#)1. (C) SUMMARY: Over the summer, some foreign oil and gas companies, hoping to make progress on proposals they submitted to the government months ago, were in a "wait and see" mode, after Turkmenistan's hydrocarbon officials gave them subtle hints that responses could be forthcoming or policies changing. Other companies met with unexpected challenges, such as unforeseen costs, reduced production forecasts and problems brought on by Turkmenistan's foreign currency exchange reforms. The April incident in which Azeri gunboats shooed away company ships, claiming they were in Azeri territory, have given companies operating in the Caspian reason to take greater caution there. Government officials continued to hint that the policy of denying onshore contracts to foreign companies might end, but no one in the foreign oil and gas community can point to concrete evidence that the policy change is around the corner. END SUMMARY.

## AZERBAIJAN - A SHADOW OVER THE CASPIAN

12. (C) As companies continued to press forward with efforts to participate in the development of the country's hydrocarbon resources, a decline over the summer in the Turkmen-Azeri relationship has thrown a shadow over prospects for development in the Caspian. While there continued to be regular indications that Turkmenistan and Azerbaijan were continuing to expand commercial-level contacts, it also appeared that political contacts between the two countries had worsened (REF A). Turkmen officials told U.S. representatives that Azeri interlocutors were saying one thing to Americans and something different to the Turkmen, leaving Turkmen officials wondering if they could trust the Azeris. Additionally, Turkmenistan officials seem to believe that they have carried all the water in advancing the relationship, with Berdimuhamedov making the initial telephone call to President Aliyev and traveling to Baku. From Berdimuhamedov's perspective, the lack of reciprocal treatment from Aliyev, particularly the absence of an Aliyev visit to Ashgabat, smacks of a superiority complex that could impede the chance of the equal relationship that Turkmenistan wants with its neighbor and potential business partner. Although bilateral political contacts have continued, the quality of the dialogue seems to have declined substantially.

13. (C) The Azeri gunboat episode in early April, however, had the most damaging effect on Turkmen-Azeri relations.

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Buried Hill, which has a contract from the Government of Turkmenistan to work Block III, the location of the contested Serdar/Kyapaz field, was carrying out seismic explorations on and immediately around Serdar island. However, Petronas was concurrently carrying out its own exploratory drilling of small pockets immediately to the north and west of its large gas field (the Livanov Bank Central field) in Block I, which it suspects have oil deposits. Although the ships towing the Petronas rig reportedly were in Block I waters the entire time -- and well east of Azerbaijan's claimed boundary -- they triggered Azeri alarms as they explored the waters immediately to the west of the Livanov Bank Central field. Two Azeri border guard boats came to investigate and ultimately demanded that the Petronas rig relocate a short distance east (REF B). In the weeks following the incident, multiple independent sources in Turkmenistan reported similarly that not only did the Azeri border guard boats not intercept the rig on the west side of the median line (as the Azeris claim), but that the Azeris actually went several kilometers beyond the boundary of the disputed Block III, through which the median line runs, into undisputed Turkmen territory in Block I, in clear violation of Turkmenistan's sovereignty. Regardless, the foreign companies exploring the Caspian on behalf of Turkmenistan may be taking greater pains to stay clear of geopolitical disputes that could put their operations at risk.

## CHEVRON OPTIMISTIC ABOUT ONSHORE DEAL

14. (C) Prospects for Chevron started looking up in August. Chevron's country manager received two letters from Minister of Oil and Gas Hojамuhammedov indicating Turkmenistan's readiness to open negotiations on the company's proposal to work natural gas onshore (REF C). On August 25, both Hojамuhammedov and Muradov at the State Agency personally confirmed that they will be ready to begin negotiations after September 15. The two officials indicated the government would not be prepared to discuss the company's proposal until after the Chinese president's visit, the Baku oil and gas conference, and the State Agency's internal reorganization were concluded.

15. (C) Given the delay in negotiations, the company is postponing plans for a company vice president to come to

Turkmenistan to potentially meet with the president. The visit will be rescheduled once negotiations have started, and in the course of the visit, Chevron will deliver a sweetener, in the form of a 6-12 month internship program at Chevron for 3-4 hydrocarbon sector workers. It is a new program at Chevron, and the company is hoping to pilot it in Turkmenistan. Even further down the road, Chevron has decided that providing training to hotel personnel in the Avaza Tourist Zone could fit in with its work force development focus on education, development of small and medium enterprises, and healthcare. The country manager asked for U.S. government assistance in helping to assure that movement toward negotiations continues. Chevron, which is hoping to land either a PSA or a concession agreement, is eager to begin negotiations, not least of all because it now believes that the Gaffney-Kline audit of the South Yoloten-Osman field will show that the field's sub-salt natural gas volumes may be even larger than earlier government predictions, amounting to more than seven trillion cubic meters of gas, or possibly much more.

BP AND TNK-BP AWAITING SEPARATE RESPONSES

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16. (C) While BP had come to Turkmenistan looking for an agreement to carry out offshore hydrocarbon production, the country manager reported in August that authorities had begun urging the company to set its sights broader and submit a proposal to drill for hydrocarbons throughout Turkmenistan, including onshore. BP was reviewing its bid to decide how an onshore program would fit into the company's overall strategy for Turkmenistan (REF D). Western press reported on September 1 that BP's Russian joint venture TNK-BP Holding, which is still caught up in a complicated shareholder conflict, was still engaged in separate talks with the Turkmen government on a proposal it submitted last year to develop onshore oil and gas fields, possibly in the Amu Darya region. It also indicated that BP may have submitted a proposal to develop several offshore blocks.

17. (C) TNK-BP, which has had an office here since September 2007, submitted PSA proposals last year to work several undisclosed offshore blocks in which several other companies also were interested. (NOTE: Nefte Compass reported that both BP and TNK-BP independently are bidding on Block 21, one of three blocks for which Lukoil/ConocoPhillips have been negotiating for more than a year. END NOTE.) In the meantime, TNK-BP submitted an offer to assist Turkmenistan with oil recovery in old fields. It also carried out 3-D seismic imaging of the (onshore) Kotur Tepe field, located in western Turkmenistan (REF E).

BURIED HILL DONE WITH IMAGING AND NOW EXPANDING ITS PRESENCE

18. (C) Canadian oil firm Buried Hill, which has a contract from the Government of Turkmenistan to develop the disputed Serdar/Kyapaz field in Block III, had concluded key seismic work there but continued to conduct work in the area. The company will soon be expanding its presence in Ashgabat. The company was hoping to move soon into new, larger offices that would be located in an elite apartment building not far from the Arch of Neutrality in the city center. General Manager Eldar Iskanderov was anxious to move because the company is planning to increase its staffing levels in its Ashgabat office by 200 people in the very near future (REF F).

19. (C) The company completed 3,000 kilometers of seismic imaging in Block III, and is now planning to drill three exploratory holes in the first quarter of 2009, although State Agency officials have been pressuring the company to drill sooner. While Buried Hill had a chance to see first-hand on April 11 that the Azerbaijanis were taking their claim to much of Block III seriously, the company said it is unconcerned that a similar incident could occur when it begins drilling (REF G). Most energy development observers

continue to theorize that Buried Hill, which lacks any experience in deep-water drilling, will eventually move to sell the PSA area at a profit.

#### PETRONAS' LOWERED EXPECTATIONS

¶10. (C) Petronas has been scaling back expectations for its gas production, after learning that without additional drilling activity, the company will only be able to produce about 5 billion cubic meters of natural gas per year in Turkmenistan's Block I (Livanov), instead of the 10 bcm it anticipated. The company could drill at more sites, but this would increase the overall cost, making higher production economically unattractive. Consequently, Petronas scaled back plans for the gas processing plant it has been building on Turkmenistan's Caspian coast north of Turkmenbashi. The

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plant will now handle only 5 bcm of gas per year. The company has determined that the Livanov structure is highly faulted. The gas is contained in a series of compartments that would require multiple drilling sites. The company seemed to be resigned to produce smaller-than-expected volumes of gas (REF H). Petronas could seek certification for larger volumes if the cost structures were to make the additional drilling sites economically attractive and could probably bring those new sites on board within three years.

¶11. (C) The news from Livanov will have serious implications for plans for an interconnector pipeline. Even if Petronas is being conservative in its estimates, the large gas production volume Petronas was initially projecting would have allowed Turkmenistan to satisfy the demands of both a Caspian littoral pipeline (northward) and an interconnector pipeline to Azerbaijan. Until the economics change or unless Petronas is able to find additional large fields, an interconnector pipeline may find itself competing with the Caspian littoral for the limited natural gas available from the Caspian.

#### WINTERSHALL DRILLING WITH OPTIMISM

¶12. (C) Wintershall began exploratory drilling in mid-July in the southern part of Block 11, for which the company holds a production sharing agreement. The company is using the Maersk Explorer --a semi-submersible rig -- that recently arrived in Turkmenistan from Russia's Central block. So far, Wintershall had not found a commercially exploitable reserve, but was hoping to hit the jackpot this time, since it believes that its drilling location lies along the same geological structure on which Petronas' gas-rich Livanov field lies (REF I). The Explorer was to work for Wintershall for 45 days. The company had another reason for its optimism. Wintershall's country manager said that in July, government hydrocarbon officials suggested that the company submit an onshore proposal. Wintershall views this as a hopeful sign that the government could reconsider its stance on onshore contracts for foreign companies.

#### BURREN/ENI TROUBLED BY STRIKE

¶13. (C) In June, post confirmed a German press report that on June 6, 600 local employees of the British company, Burren Energy (now a subsidiary of ENI), initiated a strike with the goal of demanding an increase in their wages, paid in dollars, to account for the changes in the dollar exchange rate that led to a 45 percent reduction in the value of their earnings since January 1 (REF J). The workers asked Burren managers at the site to send their strike demands to the company's office in Ashgabat. After hours of waiting for a response, the protesters broke into the company's offices near the Nebitdag oil field, and reportedly destroyed office equipment, cars, and other company property. Government authorities quickly deployed OMON (Ministry of Internal Affairs special duties unit) and special Ministry of National Security (MNB) troops to quell the protest. Government

forces reportedly detained 62 people, who were taken to a regional MNB detention center. A company representative later downplayed the incident, saying that no more than 100-150 local employees had participated in a peaceful action, and denied that company property was damaged or employees were detained. The representative did, however, comment that the company would cooperate closely with the government to resolve the issue. ENI company officials were communicating regularly with Turkmenistan authorities and

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were hopeful that the company's full cooperation would offer ENI an opportunity to rehabilitate its image here. However, post confirmed that, as of mid-August, ENI officials still have not been given visas to begin work in Turkmenistan.

CONOCOPHILLIPS/LUKOIL LOOKING TO PART WAYS?

¶14. (C) ConocoPhillips, bidding with its partner Lukoil on production sharing agreements (PSAs) for Turkmenistan's offshore Blocks 19, 20 and 21, was very close to resolving all outstanding issues in its negotiations with the Government of Turkmenistan this summer and even accepted a non-standard arbitration arrangement. However, on June 14 Executive Director of Turkmenistan's State Agency for Management and Use of Hydrocarbon Resources Bayrammurat Muradov implied more directly than ever before to a senior regional ConocoPhillips representative that the key hang up in the deal was the U.S. company's partnership with Lukoil (REF K). Muradov hinted that Lukoil's strategy of pursuing a PSA through a meeting between Lukoil CEO Vagit Alikperov and President Berdimuhamedov was poorly received in Turkmenistan's hydrocarbon bureaucracy. The company has the capacity to amend the partnership with Lukoil, but doing so would remove the time advantage ConocoPhillips now has over its other competitors for the blocks.

¶15. (C) After a year of negotiations with Turkmenistan's hydrocarbon bureaucracy, in which ConocoPhillips made an increasing number of concessions, only four minor issues and the Lukoil partnership dilemma remain. Although arbitration had at one time been a major point of difference, ConocoPhillips had resolved the issue during the April 17-18 "Oil and Gas in Turkmenistan" conference in London. Senior ConocoPhillips representatives accepted Turkmenistan's demand that any future contract arbitration take place at the International Arbitration Court in Stockholm, and that Turkmen courts would be responsible for enforcing any decision. ConocoPhillips had also agreed to increase the size of the signing and discovery bonuses.

MARATHON INCHING CLOSER

¶16. (C) In late August, senior Marathon executives gave a presentation to a core group of Turkmen oil and gas experts the day before on the joint project definitional study for a specific onshore field and refinery project that they proposed some months ago. The company representatives were planning to reconvene with the same group on August 28 in the hopes of getting some feedback on the plan (REF L).

¶17. (C) In July the company had signed a confidentiality agreement with the State Agency connected to the joint project definitional study. Marathon was proposing an integrated project that would involve handling gas from the time it is in the ground through gas-to-fuels refinery production. The ideal would be to find a discovered -- but not yet worked -- field. As part of Marathon's "integrated" approach, it would extract the gas, treat the gas to remove the sulfur, and refine it further in a gas-to-fuels plant, all in a joint venture framework (REF M). Marathon's proposal to establish a gas-to-fuels plant in Turkmenistan must be of interest to Turkmenistan officials, who have shown increasing enthusiasm in recent months for becoming involved further up the value chain, including in petrochemical production.



¶18. (C) Senior Marathon officials continue to perceive that

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Turkmen government officials are actively mulling over the question of allowing foreign oil and gas companies to work onshore. With little certainty regarding when or how the company will move to the next step in the negotiating process, representatives were convinced that sponsoring and delivering a presentation at the November 2008 TIOGE conference will provide another opportunity to get the company's name and its expertise in front of senior oil and gas officials.

#### EXXONMOBIL CIRCLING THE FRAY

¶19. (C) In September, ExxonMobil had not yet submitted a bid to do onshore exploration and development. The company says it is trying to get a better sense of what the Government of Turkmenistan wants, in order to tailor its bid to meet those requirements (septel). The company has been pushing since June for a meeting for its Executive Vice President of Exploration with President Berdimuhamedov -- so far, unsuccessfully. The company wants to package its services as an extraction-to-power producer. Thus, ExxonMobil intended to propose to expand the electrical production facilities that it would need to power its facilities to include electricity for Turkmenistan's people. ExxonMobil is also hoping to bring to the bargaining table its technology for reinjecting H2S to maintain the well's pressure, rather than dumping tons of sulphur on the surface, as has been done in Kazakhstan (REF N).

#### OMV/AUSTRIA'S TWO PROPOSALS

¶20. (C) Austrian oil company OMV was marketing two possible gas deals with Turkmenistan, according to a senior company representative in mid-June. In the first, OMV would "purchase gas at the border" in the Caspian. OMV was willing, possibly with Azerbaijan's SOCAR, to build the production pipeline to link Turkmenistan's and Azerbaijan's offshore infrastructures. OMV was looking at Turkmenistan's offshore Livanov field for the gas (Livanov is Block I, currently worked under a production sharing agreement by the Malaysian oil company Petronas). OMV was also prepared to bid on an integrated project onshore in the Amu Darya Basin in eastern Turkmenistan. Under this plan, an OMV-led consortium, working under a service agreement, would carry out exploration and development of onshore fields. The consortium would take its payment in gas, and would reinvest at least some of the funds into Turkmenistan's petrochemical industry (REF O). OMV's consortium would propose to do everything, requiring Turkmenistan simply to take the cash and accept OMV's presence in the country. The company had not yet heard a response to its proposals.

#### MIDLAND OIL STILL LACKS FOOTHOLD

¶21. (C) Midland had submitted a bid in mid-April to perform drilling intensification and improvement of existing wells south of Balkanabat (previously Nebitdag) and company representatives were hopeful that the company would receive a service contract over the summer. In the meantime, the company tried to get registered and open a new office (REF P). However, Midland may have fired its local representative, Vyacheslav Vysotsky this summer, after U.S.-based company representatives learned he may have been engaged in bid negotiations with the government without their approval, according to a translator who briefly worked for Midland. After the company's accountant, who was to oversee Midland's office refurbishment and registration, was refused

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a visa, the company decided to re-group and consider its next

steps. As of August, Midland still did not have a local representative or office.

#### CNPC QUIETLY MAKING PROGRESS

¶22. (C) CNPC was continuing with its work on the Turkmenistan-China pipeline and the fields and facilities that will support it. Press sources and Chinese officials have continued to maintain that the Turkmenistan-China pipeline will be completed in 2009, although domestic competition for construction materials may push the completion date further off. More importantly, however, Berdimuhamedov met Chinese President Hu Jintao when he made an official visit here August 29-30, and they were reportedly close to signing a new framework agreement. During his mid-August visit to Beijing for the Olympics, Berdimuhamedov announced that Turkmenistan would deliver 40 bcm per year of gas to the new pipeline, some 10 bcm more than the countries had agreed to in July 2007 (REF Q). Turkmen press reported that some 17 bcm of what is promised will come from areas that CNPC is developing along the Amu Darya, and the remaining 13 bcm will come from other nearby fields, in exchange for the gas processing and purifying facilities CNPC is constructing in Lebap Province. The gas processing facility is to be completed before the end of December.

¶23. (SBU) During Hu's visit the Turkmen press also claimed that the Samandepe and Altyn Asyr gas fields that CNPC is developing have estimated reserves of 1.3 trillion cubic meters of natural gas, in addition to that of the Bagtyyyarlyk field. CNPC's subsidiary company, International-Turkmenistan, was doing the exploratory and development work at these fields at an assertive pace, and has enlarged its presence in Lebap Province since June. CNPC recently acquired additional office space, and now occupies both the Aziya hotel and the Dayanch hotel in Berzengi. In late August the company advertised some 470 job vacancies.

¶24. (C) COMMENT: Post has high hopes that once a new staff and leadership is in place in the State Agency, many of these companies will finally see some progress with their long-awaited negotiations. A firm policy decision regarding foreign energy companies working onshore would, by itself, loosen the cork. END COMMENT.  
CURRAN